The Director of Central Intelligence

Washington, D.C. 20505

National Intelligence Council

NIC 03973-85
7 August 1985

MEMORANDUM FOR: Director of Central Intelligence

FROM: David B. Low
National Intelligence Office for Economics

SUBJECT: Opportunities for Private Sector Investment in LDCs

1. I have accumulated some information on this topic, as follows:

Attachment A: A list of countries where generally favorable investment policies exist, together with some specific examples of successful investments.

Attachment B: Materials which describe a Department of Commerce program for stimulating profit-making ventures between the private sectors of the US and other countries.

2. You will note that the Commerce Department program in Israel is well underway and has been quite successful (out of some 100 ventures which have been started, 30 are already profitable). The program in India is in the final stages of preparation and will also be capitalized with approximately $100 million, one-half of which is provided by the US Government. Korea is eager to initiate such a program, and this one might be funded entirely by private money. There is interest in the EC in developing a model program in Belgium which the rest of the EC could emulate. A similar program initiated by OPIC in the Dominican Republic may be expanded into this format with Commerce assistance. The first area of concentration in the Pacific is Australia.

3. I can describe how the Commerce Department effort works in more detail at your convenience.

David B. Low

Attachments:
As Stated

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LDC INVESTMENT OPPORTUNITIES

While nearly all developing countries have indicated that they favor increased foreign direct investment, in practice many are hesitant to allow an increased foreign presence in their countries. Moreover, the provision of a stable economic environment and the adoption of appropriate financial and exchange rate policies are in many cases as important as favorable investment policies in attracting foreign investors. Some of the LDCs with more favorable investment policies include the following.

- o Ecuador relaxed many of its restrictions on foreign investment at the end of 1983, and new investment more than doubled during the first half of 1984. Tax incentives are very generous, and regulations on profit remittances have been eased. Policies on foreign ownership have been criticized by investors as too restrictive, but Quito is considering modification of those guidelines.

- o Malaysia recently revised its already favorable investment guidelines to allow foreigners to own a greater share in their investments. There are no restrictions on repatriation of profits, and tax treatment is generally favorable.

- o Pakistan has a liberal policy toward foreign investors to encourage industrial development. Profit remittances are allowed freely where the investment is made with the government's approval. There are no regulations on the degree of foreign ownership, but it is expected that local currency expenditures will be met from local equity capital.

- o Turkey has experienced an increase in investment since 1980, following establishment of a streamlined procedure for investment approval. Regulations on profit remittances, repatriation of capital, foreign ownership, and taxes generally are liberal. Virtually all sectors of the economy are open to investment.

- o Brazil, in general, maintains a liberal policy toward foreign investment, although special policies have been implemented in areas deemed of national interest such as the petrochemical and telecommunications sectors. There are no restrictions on repatriation of capital, but profit remittances above a certain level are subject to a supplementary tax.

- Morocco implemented a new industrial investment code in February 1983, which provides for full foreign ownership and an easing of repatriation of capital. There also are special incentives for investment in the tourism sector.

- Mexico issued foreign investment guidelines in February 1984 that specified that majority foreign ownership would be allowed in certain priority sectors such as heavy machinery, electronic equipment, and high-technology products. Recently, Mexico approved a fully owned investment by IBM, which is encouraging to other investors. Investment regulations are relatively favorable, although investments are subject to close government scrutiny.

In addition, some LDCs have recently introduced policy changes designed to attract foreign investment to countries that previously were not considered attractive.

- Haiti announced in January 1985 a new, progressive investment code, which eliminated barriers to entry for new investors and expanded fiscal incentives for investors such as tax breaks. The measures not only are designed to attract foreign investors but to encourage domestic investors to keep their money in the country.

- Ghana published a new investment code last month, which increased incentives for foreign investors. Most of the changes pertained to a broadening of tax benefits.

ACTIVITIES OF INDIVIDUAL FIRMS

Many firms of varying size have made successful investments in developing countries.

- Aluminio, which is 44 percent owned by ALCOA, spent $70 million in late 1984 to more than double capacity at its Veracruz aluminum plant in Mexico.

- General Electric Company, which has operated in India for years and is reporting strong sales, is investing an additional $5 million in a 40 percent-owned affiliate to make medical ultrasound equipment and computer controls for machine tools. GE also plans to conclude a deal of up to $500 million with an Indian partner to produce three gas turbine generators.

- General Motors and Isuzu, with a combined 51 percent interest, entered into a $40 million joint venture in late 1984 to manufacture light and medium trucks and buses. There is no Egyptian government investment in the project, which is expected to reach full production capacity by the second half of 1986.

Meanwhile, domestic LDC firms also have had success in their private sectors.

- Kato Aromatic, an Egyptian private sector firm, has grown from a small operation to the largest world producer of jasmine, geranium essence, and violet essence. Most of Kato's production is marked for export, but licensing arrangements have been obtained to manufacture Dial soap products, McCormick spices, Buitoni macaroni products, and other goods.

- Dreamland Spring, a Malaysian mattress producer, was established in 1979 in competition with Dunlop, the giant tire and mattress maker near Kuala Lumpur. By 1984, Dreamland had established itself in Malaysia and has entered into a joint venture to open a small plant in Shanghai, China by yearend 1985.

There also are numerous projects guaranteed or financed by OPIC over the past few years that illustrate the development potential of smaller investments.

- In Costa Rica, expansion of acreage for a tropical houseplant export project will generate some 500 new jobs and is expected to earn $10 million in foreign exchange over a five-year period.

- In Sri Lanka, expansion of a rubber tire manufacturing company will create 92 local jobs and introduce advanced molding technology to the country.

- In Rwanda, expansion of a tea factory will create 103 jobs, generate $3.4 million in foreign exchange earnings, and provide an expanded market for 3,000 farmers who belong to the cooperative which sells tea to the factory.

- In Pakistan, a project to produce pharmaceutical products ultimately will employ 139 workers and save the government $35 million in foreign exchange annually.

UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Productivity, Technology and Innovation
Washington, D.C. 20230
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ATTACHMENT B

INTERNATIONAL COOPERATION IN TECHNOLOGY DEVELOPMENT

True international cooperation in the development of commercially practical technology rarely occurs. U.S. firms, as well as those of other technologically advanced countries, tend to perform the research, development and commercialization of new products and processes in-house and then attempt to sell or license the resulting product. Yet frequently a cooperative partnership with a qualified foreign firm can be beneficial to both parties, while reinforcing economic interests or positive political objectives. Building upon the highly successful partnership existing with Israel, the Office of Productivity, Technology and Innovation of the Department of Commerce would facilitate the formation of U.S./foreign firm joint ventures. Working with the Department of State and other international agencies, OPTI encourages foreign governments to create a mechanism to establish joint ventures with the United States.

The advantage to the foreign countries in participating in this program as an equal partner is manifest. And it opens an innovative, exciting new chance for U.S. firms not presently active in world markets to become active partners with foreign companies in fully competitive world-wide ventures. Foreign firms can contribute: unique technology; technological development capability and manpower; natural resources unavailable here; cheaper access to some markets, capital and special skills; lower labor costs; and special manufacturing facilities. By the same token, U.S. firms can offer contributions, such as access to research developments and entrepreneurial skills, which complement those of their potential partners. Combining each party's special talents, facilities and resources can produce extraordinary results.

The Binational Industrial Research and Development Foundation (BIRD-F), a U.S./Israel joint venture, is being used as a model. BIRD-F was established in 1977 by an endowment of $60 million. The interest, $5 million/year, is used to fund half the cost of projects proposed in Israel to a maximum of $300 thousand/year for three years. At least 25% of the cost must come from the Israeli partner and an equal amount from the U.S. partner. The BIRD-F management office, consisting of five people, evaluates proposals, examines the financial plan, assesses the commercial feasibility, and will help in securing a U.S. partner. Careful screening of proposals has resulted in a success rate of over 90%. Following commercialization, BIRD-F receives payment based on sales until 150% of funding is returned. Funding is written off if the project is unsuccessful. A Board of Directors, consisting of

three U.S. and three Israeli government officials, provides policy guidance. Support groups of industrialists exist in each country to assist the BIRD-F Executive Director in locating opportunities. BIRD-F will now assess feasibility of projects when requested, even if funding is not desired. By such activities, BIRD-F has helped reinforce the entrepreneurial infrastructure for technological development in Israel. Examples of successful projects include a microprocessor controlled telephone switchboard, a computerized drip irrigation system, software packages, and a heart pacemaker.

Analysis of the BIRD program's success indicates the following points (not necessarily in order of importance):

1. An extremely competent Executive Director;
2. A small, capable management staff covering technical, financial and administrative areas;
3. No political interference;
4. A governing board for policy guidance;
5. Removal from concern of annual appropriation requirement;
6. A slow start initially, but then a momentum of its own;
7. High credibility within the technical and entrepreneurial communities;
8. The existence of persons highly educated in technology in Israel;
9. Good (but not perfect) communications between Israel and the U.S.;
10. A multiplier effect--once interactions are established, they proceed without interference from the BIRD office; and
11. Transition from partial funding to management review.

On the basis of this analysis, we suggest that promotion of the formation of joint ventures between U.S. companies and those of other foreign countries be undertaken using the BIRD-F model. The questions that immediately arise are whether the U.S. start-up funding (1/2 of the total initial cost) was necessary for the success, and secondly, whether the U.S. had a special relationship with Israel which caused companies to be more willing to enter into joint ventures. To answer the second question first, without an exception, those U.S. companies which invested their own money

in the partnership did so because of the potential for making a profitable return on their investment. The question of financing the program is a little more difficult to answer. Without a doubt, the cost sharing arrangement did reduce the financial risk.

On the basis of the above analysis, it would appear an opportune time for the U.S. and other countries to begin discussions on the feasibility of establishing a small management office which would encourage the establishment of joint ventures in technology development. The advantages to the foreign country are clear--it would be an opportunity for one of its companies to work as a partner with a U.S. company to expand the economy of both countries, and not merely transfer an aging technology to take advantage of a lower cost labor force. On the basis of the evidence of the past decades, numerous countries possess both the industrial know-how and the technical infrastructure which would make its industries mesh well with those in the U.S. What appears to be needed is something to catalyze the formation of these partnerships. We believe that the proposed management office concept would serve this function if properly established.

Funding of this activity with foreign countries is still to be determined. The U.S. government, in general, will not provide funds directly. Just the involved nature of the U.S. budget process precludes that. Furthermore, the political philosophy holds that because it is in the enlightened self-interest of U.S. companies to embark on such activities, removing barriers to such international cooperation is the proper government role. On the other hand, in lieu of direct funding, the Department of Commerce's Office of Productivity, Technology and Innovation is prepared to offer the following services:

1. Assistance in selecting an Executive Director, plus providing training for that person and certain foreign government officials on how to establish the management office;

2. Instructions on how to determine a potential project's commercial viability via sensitivity analysis, forward business planning, constraint analysis, and project screening techniques;

3. Development of a support mechanism to bring companies together on the basis of mutually compatible goals and strategies;

4. Working with other government agencies, identification of possible sources of financial support.

However, when AID funds are available in a developing country, there is the possibility that some may be used for support.

Since the primary beneficiary of this program will be the foreign country, it appears reasonable to anticipate the direct operating cost for the management office be the responsibility of the foreign country. At a minimum, this would include about $300,000 for salaries and expenses of the office staff. At the lowest level of operation, the management office would review the technical proposals and then search out partners in the U.S. for participation in the joint ventures. At the next level, the management office would share in the cost of the three-year development program and would require additional funds.

Sources of such funding include direct contribution from the foreign government, funding by AID for certain developing countries, the Asian Development Bank, the World Bank, private venture capital, OPIC, Research and Development Limited Partnerships (RDLPs), and possibly other sources. Once a decision to explore this proposal is taken, a concerted effort to tap these potential sources of support should be undertaken.

Implementation

Once an agreement in principle between the U.S. and the foreign country is reached, the following steps are indicated:

1. Designation of key individuals from both the U.S. and the other country;

2. Meeting to plan course of action, including critical paths and caveats;

3. Formal proposal; and

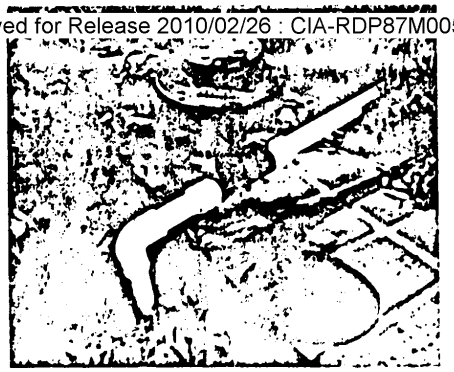
4. Final discussion and agreement.

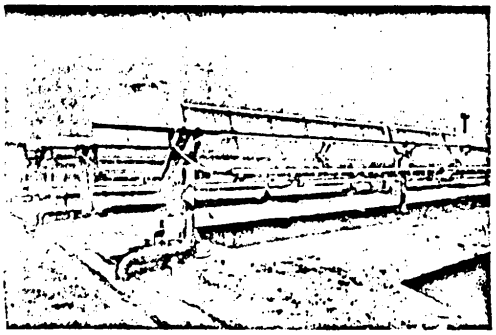
For more information, contact:

Mr. Gerald T. Underwood
Director, Office of Metric
Programs
Room 4082
(202) 377-0944

3/8/85

BIRD, founded in May 1978, based on an imaginative but untested concept for stimulating mutually profitable cooperation between the private sectors of U.S. and Israeli high-tech industry, derives its income from a $110 million endowment that was equally contributed by the two governments.





If BIRD approves the project, it will cost-share, typically 50:50, with each partner in its expenses related to bringing the innovation to the point of readiness for commercialization.

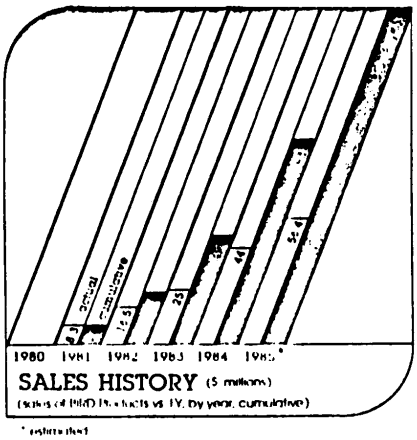
The BIRD investment, typically $5-600,000 over about 2 years, sometimes about twice that over 3 years, buys it neither equity nor technology/patents, but only the right to receive repayments, to a modest maximum, in the form of royalties on commercial revenues - no revenues, no repayments.

While the main operations of BIRD involve "full-scale projects", various other types of awards, with simplified procedures, are available for small projects and tests of feasibility. The latter class of awards are designed to encourage prospective corporate partners to test joint project waters before total immersion.

More than 90 joint projects between U.S. and Israeli companies have been initiated since the first in 1979; and more than 20 thus far have led to at least initial sales of new products. Through 1984, close to $94 million of BIRD products have been exported from Israel, mostly to their U.S. counterparts for resale or for incorporation into other products.

This highly abbreviated summary of BIRD's record demonstrates the basic validity of that early concept, namely that U.S. companies and Israeli companies have much to gain from joint development and commercialization of innovative products and processes.

Any U.S. company - Israeli company team,



The roles of the two companies in any project are typically complementary rather than similar. Thus, the U.S. company's role may be primarily in specific product definition and marketing, while the Israeli company concentrates on product development. The appropriate division of activities during development, manufacture and sales is up to the partners to decide - but note that products largely manufactured in Israel have duty free entry into EEC countries.

BINATIONAL INDUSTRIAL RESEARCH FOUNDATIONS
PROGRAM SUMMARY

July 25, 1985

Country	Initial Contact	Level of Interest/Problem Area	Status Code*
Argentina	7/84	J. Clark initiation, follow by cable to USEmbassy; no follow up Candidate for World Bank funding	S
Australia	7/85	Approached by several risk capital ventures and Procter & Gamble Representatives	P
Austria	1/84	Initially high.Lapsed.Reinitiated. 6/85 by visit of H. Chladek, new S&T Attache in D.C. Interest high. Study underway.	S
Belgium	10/84	High, with proposed plan sent to Brussels, awaiting response ITA very supportive with EEC encouragement.	S
Caribbean	2/85	Initiated by ITA/AS Goldfield DoC task force in operation	S
China	10/84	Letter from F.Haynes to Chinese Embassy; response lacking	I

*Status Code

I = Initial discussions:
G = Final govt. review pending:
N = Near formal proposal:
O = Operation started
S = Conducting studies:
P = Preliminary proposal:
F = Formally proposed:

Country	Initial Contact	Level of Interest/Problem Area	Status Code*
Finland	9/84	Contacts through J.Williams. Intial exchanges with Timo Fontynen, S&T Counselor, US Embassy.	I
France	7/85	DBM presentation in Paris stimulated great interest. Telex fr Embassy indicates group visit planned here soon to discuss. Nichols/ITA coordinating.	I
Greece	2/85	Discussed during visit of Greek S&T delegation to ITA; DoC will not pursue	I
Hungary	4/85	Contacted by World Bank to meet with Hun.Min.Industry Officials	I
Iceland	6/85	Strong interest by Prime Minister Hermannsson, Visit to DOC by Mr. Palsson 7/85, DBM invited to visit 9/85	S
India	11/83	Agreement to be signed shortly/ Final agreement with ICICI	G
Ireland	11/84	Would like a visit for description of BIRD-F. ITA Desk Ofcr. indicates high interest.	I
Israel	1975	See Separate Report	X

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Country	Initial Contact	Level of Interest/Problem Area	Status Code*
Italy	6/84	JWms letter to G.Gabrielli. DBM discussion with Dr. Chingari of ENEA and with Pirelli group referred to Dr. Keyworth (SDI program).	S
Korea	11/84	High, initial contact thru State which continues as intermediary. Discussed with Dr. Shi Kyiang Park (6/24/85) and meeting at State 6/28/85 w/Korean official delg. Interest very high	S
Mexico	2/85	Preliminary inquiries only via Small Business initiatives.	I
Morocco	6/85	Interest expressed by Minister of Commerce & Industry to DBM; Mtls sent. Discussed in DoC mtg. 7/22/85. ITA Desk enthused. Will meet with US and AID.	I
Portugal	3/84	Letter from Sec designating DBM S&T coordinator; Portugese response -5/84 US reaffirms DBM's role; Dr. Clark discussed in Lisbon 6/85	S
Romania	3/84	Initial interest high, DTG visit 7/84; follow up-12/84; overtaken by events	I
Spain	4/84	Proposed as part of US-Spain S&T cooperation; Met with E. Triana, Spain's Congressional Com., on high tech industry, 7/8/85. High interest.	S

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Country	Initial Contact	Level of Interest/Problem Area	Status Code*
Sweden	8/84	Initial response from Sweden encouraging; DBM visit 4/85, 6/85 discussion unproductive	I
United Kingdom	4/84	Interest shown by UK Science Attache and several visitors. Next group coming 7/25/85	S
EEC	6/85	Strong interest expressed to Dr. Merrifield by Mr. Mathiesjen, a Dep. Dir. of the EEC. Contacts assisted by F.Lamorello, ITA, urging we visit with EEC officials in Brussels.	I

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BINATIONAL R&D COOPERATION